VETERAN RESOURCES INC.

1995
ANNUAL REPORT

CORPORATE PROFILE

Veteran Resources Inc. is an independent junior oil and gas producer which also provides advanced drilling technology to the oil and gas industry. The Company has executed a drilling services contract in Russia through a wholly owned subsidiary, Veteran Resources Offshore (Cyprus) Limited, and is a significant shareholder in a firm providing specialized services to the drilling industry.

Veteran is based in Calgary, Alberta, and is listed on the Alberta Stock Exchange. At year end the company had issued 12.2 million shares (symbol VTI).

ANNUAL MEETING

The Annual General Meeting of the shareholders of Veteran Resources Inc. will be held in the auditorium
Main Floor, Bantrel Tower
700—6th Avenue S.W.,
Calgary, Alberta
on June 27, 1996
at 2:00 pm.

Abbreviations:

MBBL — Thousands of barrels
MMCF — Million cubic feet
BOPD — Barrels of oil per day
BOE — Barrels of oil equivalent 10:1

MESSAGE TO SHAREHOLDERS

During 1995, Veteran Resources Inc. ("VTI" or the "Company") significantly advanced the feasibility and contractual elements for a major drilling project with significant potential in Western Siberia. Although suitable financing and / or joint venture terms were not concluded by year end, management is confident that the project will be undertaken in 1996.

During the year, participation terms were negotiated with Uganskneftegas and draft foundation and charter agreements were developed for "Ugansk Resources", a proposed Russian Joint Stock Company wherein Veteran Resources Offshore (Cyprus) Limited will have a 45% ownership. Suitable rig equipment was located for the project and certain long lead time items were ordered so that the Company could meet a very compressed delivery schedule when all arrangements are finalized.

Veteran Resources Inc. has written down its oil and gas assets by $887,000. This was predicated by lower year end product prices, reclassification of gas reserves as a result of an outside operator decommissioning a gas plant to which the Provost property had been producing, and by including non-producing lease rentals which had been previously capitalized.

Veteran Resources continued to actively pursue property acquisitions in Western Canada and was successful in acquiring 2,080 net acres of exploratory land at Red Earth, Alberta. Prior to year end the Company entered into a seismic option agreement with an industry partner who completed a seismic program subsequent to year end and has drilled a successful exploratory well in early 1996. This well was drilled at no cost to Veteran. Management anticipates that an additional well will be drilled by the industry partner in order to earn the remaining acreage in the land tract.

Veteran continued to provide consulting services to the industry as companies actively pursue applications for its underbalanced horizontal drilling technology.

Management wishes to express its thanks to our Shareholders for their continued support and encouragement. Our Board of Directors and employees also deserve sincere thanks for the perseverance and hard work in order to position Veteran Resources Inc. for strong future growth.

Donald Jewitt
President

May 2, 1996

OPERATIONS REVIEW

Russian Project

The Company signed a Drilling Services Agreement with Ugansкneftegas in August 1994. Phase 1 of this agreement calls for VTI, subject to arranging satisfactory financing, to construct a suitable drilling rig, transport the rig and required materials to Western Siberia, and to drill up to six horizontal wells using advanced underbalanced technology. The test wells will be drilled in the existing oilfields of Prirazlomnoye, Salym and South Shirokovskaya where the new technology offers significant producing potential.

During 1995 VTI assigned the Drilling Services Agreement to its wholly owned subsidiary, Veteran Resources Offshore (Cyprus) Limited ("VROCL") and has negotiated terms for the formation of a Russian Joint Stock Company ("JSC")on behalf of VROCL. Draft Founders & Charter agreements call for the formation of the JSC, to be named Ugansk Resources, which will be owned 55% by Ugansкneftegas and 45% by VROCL. All investment requirements for the project and resulting benefits will be shared by the originating founders in proportion to their ownership in Ugansk Resources.

The Company is working very closely with personnel at Ugansкneftegas in order to understand, define and resolve all project elements. Detailed technical evaluations and economic viability studies have been conducted and management is convinced that the project has significant long-term potential for the Company. Management is also convinced that a Drilling Services Agreement is the most appropriate vehicle for completing the initial phase of the Russian Project.

The scope and magnitude of the venture has attracted a number of parties interested in participating in the project. Although detailed negotiations are continuing with various parties, definitive terms and financing arrangements had not been concluded at year end. It is expected that a suitable arrangement will be concluded and the project will proceed in 1996.

Airgen Corporation

Underbalanced horizontal drilling requires the use of compressed inert gas. Since VTI was seeking an alternative to its previously terminated Baugas nitrogen generation system, the Company seized an opportunity to obtain an ownership in a Company providing such a service. In March 1995, VTI received 1,000,000 shares of Airgen Corporation for a nominal amount in exchange for providing bridge financing to Airgen in 1995 and which financing was fully repaid. Airgen is now listed on the Alberta Stock Exchange with a share trading price in March 1996 of $0.31/share. Airgen provides compressed inert gas services to the oil and gas industry. The Company anticipates that demand for Airgen's services will increase as underbalanced horizontal drilling technology is more widely accepted world wide. Veteran may access this expertise in equipment selection, construction and operation for its Russian project.

Canadian Exploration and Production

Gross revenues from the Company's oil and gas production increased by 10% to $639,063 from its properties in Provost and Barons. Minor exploration and production operations were conducted in Western Canada as the Company focused its attention on the Russian project.

A number of acquisition opportunities were evaluated and pursued during the year, however, management was of the view that industry price expectations were too high, particularly given the very low prevailing gas prices in 1995.

VTI purchased 3.25 sections of P&NG rights in the Red Earth area of Northern Alberta. Prior to year end the Company entered into a seismic option agreement with an industry partner. Subsequent to year end, the seismic program was completed and a successful gas well was drilled. It is anticipated that further work will be carried out by the industry partner in order to earn the balance of the acreage in the tract.

CANADIAN LAND HOLDINGS

At year end the Company's land holdings were:

	Gross Acres	Net Acres
Provost	9,120	4,560
Barons	480	273
Michel	3,840	720
Red Earth	2,080	2,080
TOTAL	15,520	7,633

Present Value of Reserves (before tax, using escalated prices)

Thousands ($)	Undiscounted	Discounted @ 15%	Discounted @ 20%
Proven	2,850	1,241	1,041
Probable	173	69	54
Sub Total	3,023	1,310	1,095
Alberta Royalty Tax Credit	34	24	22
Total	3,057	1,334	1,117

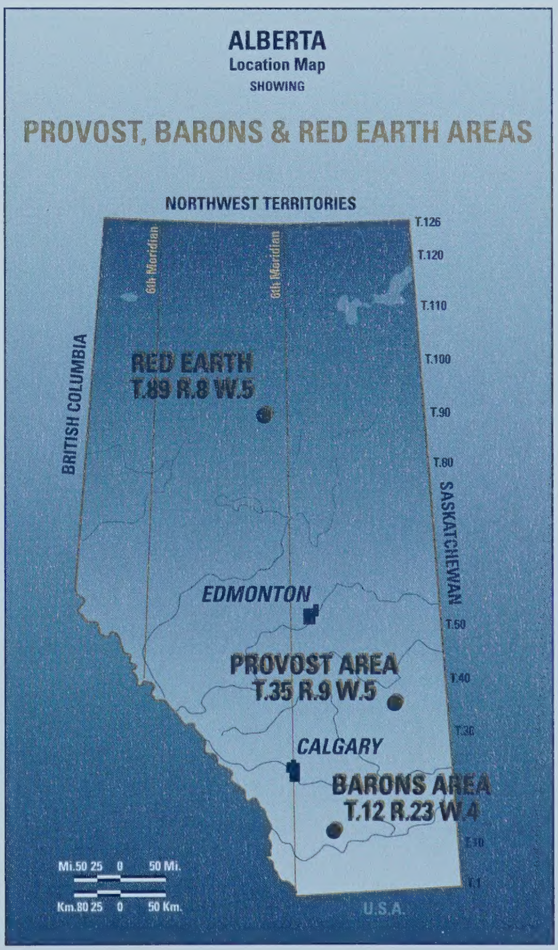
The value of probable reserves has been reduced by 50% to account for risk.

RESERVES

The Company's proven and probable oil and natural gas reserves at January 1, 1996 were evaluated by Sproule Associates Limited as shown in the following tables. The Company's gas reserves in the Provost area were written off, since the gas plant through which the reserves were being processed was shut in by the outside operator.

Reserves (before royalties)

Crude Oil (MBBL)	
Proven	271.2
Probable	21.7
Total	292.9



AUDITORS' REPORT

To the Shareholders of Veteran Resources Inc.

We have audited the consolidated balance sheets of Veteran Resources Inc. as at December 31, 1995 and 1994 and the consolidated statements of loss and deficit and changes in financial position for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1995 and 1994 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

Coopers & Lybrand

Chartered Accountants
Calgary, Alberta
March 19, 1996

MANAGEMENT'S REPORT

The accompanying financial statements and all information in this annual report are the responsibility of management. The financial statements have been prepared by management in accordance with generally accepted accounting principles, and in the opinion of management, present fairly the financial position and results of operations of the Company within acceptable limits of materiality. Financial and operating information presented elsewhere in the annual report is consistent with the results summarized in the financial statements.

Management maintains appropriate systems of internal controls designed to provide reasonable assurance that assets are safeguarded and that accounting systems provide timely, accurate and reliable financial and operational reporting. The accuracy of the financial reporting has been examined by external auditors. The Board of Directors is responsible for ensuring that management fulfills its responsibilities for stewardship and financial reporting and is ultimately responsible for reviewing and approving the financial statements.

Don Jewitt
President

Brian Schmidt
Secretary-Treasurer

CONSOLIDATED BALANCE SHEETS

As at December 31, 1995 and 1994	1995	1994
ASSETS		
Current Assets:		
Cash and short-term deposits	$ 688,158	$ 1,416,773
Accounts receivable	106,543	259,469
Prepaid expenses	15,822	14,167
	810,523	1,690,409
Investment (note 3)	—	—
Capital Assets (note 4)	1,121,121	1,758,434
Deferred Expenditures (note 5)	706,831	332,143
	$ 2,638,475	$ 3,780,986
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable and accrued liabilities	$ 514,613	$ 556,369
Provision for site restoration costs	148,276	102,195
	662,889	658,564
Shareholders' equity:		
Capital Stock (note 6)	3,961,162	3,951,295
Deficit	(1,985,576)	(828,873)
	1,975,586	3,122,422
	$ 2,638,475	$ 3,780,986

SIGNED ON BEHALF OF THE BOARD

Director

Director

CONSOLIDATED STATEMENT OF LOSS AND DEFICIT

For the Years Ended December 31, 1995 and 1994	1995	1994
Revenue		
Oil and gas production	$ 639,063	$ 579,145
Royalties	37,293	36,211
	601,770	542,934
Consulting	435,444	481,050
Interest	55,929	83,866
	1,093,143	1,107,850
Expenses		
Baugas equipment write-off	$ —	$ 793,038
Operating	213,704	220,964
General and administrative	485,046	527,070
Consulting	317,912	320,671
Site restoration costs	46,081	34,209
Depletion and depreciation	1,187,103	174,365
	2,249,846	2,070,317
Net Loss for the Year	(1,156,703)	(962,467)
Retained Earnings (Deficit)—Beginning of Year	(828,873)	133,594
Deficit—End of Year	$ (1,985,576)	$ (828,873)
Net Loss Per Share	$ (0.09)	$ (0.08)

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

For the Years Ended December 31, 1995 and 1994	1995	1994
Cash Provided by (Used in):		
Operations:		
Net loss for the year	$ (1,156,703)	$ (962,467)
Items not affecting cash—		
Site restoration costs	46,081	34,209
Depletion and depreciation	1,187,103	174,365
Baugas equipment write-off	—	793,038
Funds provided from operations	76,481	39,145
Net change in non-cash working capital	109,515	481,499
	185,996	520,644
Financing:		
Issue of common shares	9,867	1,028,546
Investing:		
Purchase of capital assets	(549,790)	(1,999,405)
Deferred expenditures	(374,688)	(279,981)
	(924,478)	(2,279,386)
Decrease in Cash for the Year	(728,615)	(730,196)
Cash—Beginning of Year	1,416,773	2,146,969
Cash—End of Year	$ 688,158	$ 1,416,773
Funds from Operations Per Share	$ 0.01	$ 0.00

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Year Ended December 31, 1995 and 1994

1. Company Operations

The Company is engaged in the acquisition of, exploration for and development and production of oil and natural gas properties in Canada. In addition, the Company has developed a new horizontal drilling technology which it makes available to the industry on a fee basis or for participating interests and which it expects to apply to the development of its own oil and gas properties.

These financial statements include the accounts of the Company and its wholly-owned subsidiary Veteran Resources Offshore (Cyprus) Limited which was acquired on December 30, 1994.

2. Summary of Significant Accounting Policies

Capital Assets

The Company follows the full cost method of accounting for its petroleum and natural gas properties and equipment whereby all costs, net of incentives, related to the exploration for and development of oil and gas reserves are capitalized. Costs include lease acquisition, geological and geophysical expenditures, carrying costs of non-productive properties, the drilling of productive and non-productive wells and related plant and production equipment costs. Proceeds on disposal of properties are ordinarily deducted from such costs without recognition of profit or loss except where such disposal constitutes a major portion of the Company's reserves.

The Company calculates a "cost ceiling" which limits the net book value of capital costs to the undiscounted and unescalated estimated future net revenues from production of proved reserves based upon period-end prices. Additional depletion is provided if the net book value of capitalized costs exceeds such future revenue. This test also accounts for future general and administrative expenses, future site restorations and abandonments, financing costs and income taxes, all undiscounted and unescalated.

Depletion is computed using the unit-of-production method where the ratio of production to proved reserves, before royalties, determines the proportion of depletable costs to be expensed. Depletable costs are reduced by estimated future salvage values from wells, plants and facilities, and undeveloped properties are excluded from the depletion calculation until the quantities of proved reserves can be determined.

Costs relating to the construction and development of drilling equipment are deferred until completion of the project. These costs will be depreciated over future periods on a basis not to exceed the useful life of the equipment. Where there is a significant degree of uncertainty as to whether sufficient revenue will be generated from the equipment, the unrecoverable costs are expensed.

Depreciation on drilling equipment and office equipment is computed on the declining balance method at the rate of 30% and 20% respectively per year.

Future site restoration and abandonment costs

The provision for future removal and site restoration costs relating to petroleum and natural gas properties, as estimated by the Company, is charged against income on a unit-of-production basis. The cumulative amount, net of actual expenditures, is recorded as provision for site restoration costs.

Income Taxes

The Company uses the deferral method of income tax allocation. Income taxes are provided at current rates for all items included in the statement of income regardless of the period when such items are reported for income tax purposes. The principal items which result in timing differences for financial and tax reporting purposes arise from claiming capital cost allowance and exploration and development expenses in excess of depreciation and depletion charged against income.

Joint ventures

A significant portion of the Company's exploration, development and production activities are conducted jointly with other entities and accordingly the accounts reflect only the Company's proportionate interest in such activities.

Per share information

Earnings per share and funds from operations per share are based on weighted average number of shares outstanding, during the period, which was 12,247,185 (1994—11,925,690). Fully diluted earnings per share as affected by stock options, as described in note 6, is not materially different.

3. Investment

On March 10, 1995, the Company received 1,000,000 shares of Airgen Corporation ("Airgen") for a nominal amount as compensation for providing bridge financing to Airgen in 1995. At December 31, 1995 these shares were not quoted, however, on March 19, 1996 the Company was listed on the Alberta Stock Exchange and the shares closed at $0.31 per share.

4. Capital Assets

Capital assets are comprised of:

	1995			1994		
		Accumulated Depletion and			Accumulated Depletion and	
	Cost $	Depreciation $	Net $	Cost $	Depreciation $	Net $
Petroleum and natural gas properties	2,034,921	1,281,127	753,794	1,790,078	189,649	1,600,429
Drilling equipment	427,154	120,693	306,461	134,447	27,385	107,062
Office equipment	74,553	13,687	60,866	62,313	11,370	50,943
	2,536,628	1,415,507	1,121,121	1,986,838	228,404	1,758,434

The Company recorded additional depletion and depreciation during the year of $887,000 relating to the write-down of its oil and gas assets.

5. Deferred Expenditures

At December 31, 1995, the Company has incurred costs of $706,831 (1994 - $332,143) relating to the Company's intention to establish a Joint Stock Company in Russia with a Russian joint venture partner. The costs are principally comprised of travel and business promotion, professional fees, salaries, and management fees charged by directors of the Company. During 1994, the Company signed a Drilling Services Agreement with its Russian partner to set out the terms and conditions on which the joint venture will proceed to field operations. This agreement was subsequently amended in 1995 to include an extension for formation and registration of the Joint Stock Company prior to initiating drilling operations on the first well of the proposed six test wells. The agreement is subject to the Company arranging financing to construct a drilling rig and to drill six horizontal wells. If the proposed Joint Stock Company is not registered or the initial well results prove to be technically or economically unsuccessful, the Russian partner has guaranteed to repay the Company's costs associated with construction of the drilling rig and drilling of six horizontal wells.

The deferred expenditures will be added to the cost of the investment in the Russian company or expensed to income, offset by amounts recovered from the Russian joint venture partner, if any, when the results of the joint venture company initiative are finalized.

6. Capital Stock

Authorized—

Unlimited number of common shares without nominal or par value

Unlimited number of redeemable preferred shares

Issued—common shares

	1995		1994	
	Number of shares	$	Number of shares	$
Balance—Beginning of Year	12,240,367	3,951,295	10,425,100	2,922,749
Issued for cash, private placement	—	—	1,300,000	812,500
Share issue costs	—	—	—	(41,588)
Issued pursuant to an exercise of stock options	19,734	9,867	515,267	257,634
Balance—End of Year	12,260,101	3,961,162	12,240,367	3,951,295

Stock options have been granted to directors, officers, employees and consultants entitling them to purchase common shares of the Company. At December 31, 1995, options to purchase 814,999 (1994 - 834,733) common shares were outstanding.

Number of Options	Exercise Price	Expiry Date
779,999	$0.50	August 5, 1998
35,000	$3.15	January 28, 1999

7. Income Taxes

The provision for income taxes reflects an effective tax rate which differs from the expected Canadian income tax rate of 44.58% as summarized below:

	1995 $	1994 $
Statutory income tax rates	44.58%	44.34%
Expected provision for income taxes	(515,658)	(426,758)
Non-deductible crown payments	16,626	27,552
Resource allowance	(16,609)	(9,893)
Future tax benefit not recognized	533,351	408,079
Other	(17,710)	1,020
Income taxes	—	—

The company has an excess of accumulated tax pools over the net book value of capital assets in the amount of approximately $1,270,000. This amount is available to reduce future taxable income. In addition, the company has non-capital losses of approximately $1,230,000. These may also be used to reduce future taxable income. These losses will begin to expire in the year 2000. The future benefit of these excess tax deductions and non-capital losses has not been recognized in the accounts.

8. Segmented Information

December 31, 1995	Petroleum and Natural Gas $	Consulting $	Corporate $	Total $
Revenue	601,770	435,444	55,929	1,093,143
Depletion and Depreciation	1,091,478	93,308	2,317	1,187,103
Earnings (Loss) Before Income Taxes	(899,113)	26,014	(283,604)	(1,156,703)
Identifiable Assets	820,220	346,578	1,471,677	2,638,475

December 31, 1994	Petroleum and Natural Gas $	Consulting $	Corporate $	Total $
Revenue	542,934	481,050	83,866	1,107,850
Depletion and Depreciation	143,932	23,279	7,154	174,365
Earnings (Loss) Before Income Taxes	143,829	(655,938)	(450,358)	(962,467)
Identifiable Assets	1,688,300	274,994	1,817,692	3,780,986

HEAD OFFICE
VETERAN RESOURCES INC.

Business (403) 266-3005 Fax (403) 261-2834
2200, 700—Sixth Avenue S.W.,
Calgary, Alberta CANADA T2P 0T8

DIRECTORS

Donald Jewitt
President
Veteran Resources Inc.

Brian H. Schmidt
Vice President Operations and Secretary Treasurer
Veteran Resources Inc.

Ivan Wytrychowski
Vice President Production
Veteran Resources Inc.

Hess Lenstra
Vice President Exploration
Veteran Resources Inc.

Derrick Armstrong
Sr. Partner
Ogilivie and Company

Stanley Odut
Sr. Vice President and COO
Alberta Oil and Gas Limited

OFFICERS

Donald Jewitt
President

Brian H. Schmidt
Secretary Treasurer

Ivan Wytrychowski
Vice President Production

Hess Lenstra
Vice President Exploration

AUDITORS

Coopers & Lybrand
Calgary, Alberta

SOLICITORS

Ogilivie and Company
Calgary, Alberta

BANKERS

The Bank of Nova Scotia
Calgary, Alberta

TRANSFER AGENTS

Montreal Trust Company of Canada

Calgary, Alberta

VETERAN RESOURCES OFFSHORE (CYPRUS) LIMITED

(Wholly-Owned Subsidiary)

DIRECTORS

Donald Jewitt
Okotoks, Canada

Carlo Civelle
Zurich, Switzerland

Charalambos Favollis
Nicosia, Cyprus

Andreas Stylianon
Nicosia, Cyprus

HEAD OFFICE

Julia House
3 Th Dervis Street
CY - 1066 Nicosia, CYPRUS

The Alberta Stock Exchange trading symbol : VTI

VETERAN RESOURCES INC.
Business (403) 266-3005 Fax (403) 261-2834

2200, 700–Sixth Avenue S.W.
Calgary, Alberta, CANADA T2P 0T8